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SUBJECT: KOSOVO: ENERGY SECTOR REFORM MOVES AHEAD (FINALLY)

¶1. (SBU) SUMMARY: After years of delay, the Government of Kosovo (GOK) has officially announced it will build a large lignite-fueled power plant -- the "New Kosovo Power Plant" (NKPP) -- to address the country's unmet and growing energy needs. Prime Minister Hashim Thaci announced the government's decision at a July 15 press conference, after close consultation with key international donors. In addition to building NKPP, the GOK also decided to offer the Kosovo B unit for privatization, to decommission the decrepit Kosovo A unit, and to accelerate privatization of the national electricity distribution system. The USG, the European Commission (EC) and the World Bank have pledged their full support for the GOK's approach, and offered direct assistance to keep the process moving forward. A donors' meeting on energy has been suggested for the fall to discuss additional financing needs for this reform of Kosovo's energy sector. While many details still need to be fleshed out, the principal donors are now finally on the same page with regard to reform of the troubled energy sector -- good news for Kosovo as this reform is perhaps the most critical component of the country's economic future and well-being. END SUMMARY.

NKPP: A Delayed Work, Now Back on Track

¶2. (SBU) In cooperation with the World Bank, the Ministry of Energy and Mining solicited expressions of interest from private investors in 2006 for a new energy development project intended to address Kosovo's unmet and growing demands for power. At the time, the project included construction of a new power plant (then titled "Kosovo C"), with an anticipated production capacity of 2100 megawatts, development of a coal mine to supply the new power plant, and refurbishment of certain production units of the existing Kosovo A plant. The future of the second existing plant, Kosovo B, was not specifically addressed in the expression of interest documents, but was not excluded from consideration by interested parties. The NKPP Project Steering Committee (PSC) then announced a short-list of four pre-qualified consortia from the expressions of interest received. These consortia would have the opportunity to bid on the NKPP tender, once issued. (Note: Three of the four consortia include American interests; the fourth pre-qualified bidder recently withdrew from the NKPP process. End Note.)

¶3. (SBU) After the expression of interest period concluded in December 2006, the NKPP project suffered from delays and inaction due to preoccupation by the Kosovo government with

the final status process and preparations for Kosovo-wide elections in November 2007. This was then compounded by the new government's desire in early 2008 to conduct a thorough review of the entire Kosovo C/NKPP process, and then by disagreement among key donors, principally the USG and World Bank, over the need to link closure or rehabilitation of the older units with NKPP so that Kosovo would be able to provide energy before the completion of the large, new lignite-burning plant.

¶4. (SBU) Re-energized by the urgings of key international donors for Kosovo to take a more pro-active approach on energy sector reform, the GOK sought guidance on how to move NKPP forward. Keeping in mind Kosovo's need for a reliable source of power while NKPP is being built and Kosovo A and B being retired, the USG and the World Bank held bilateral discussions to develop a coordinated and integrated approach to support Kosovo's energy sector reform efforts, as well as to facilitate private sector investment in this area. The results of this discussion were delivered to Prime Minister Thaci in a joint-letter on July 7. The letter advised the GOK to move forward with NKPP, and finalize the Request for Proposals (RFP) for bidders without delay. The World Bank, in turn, pledged to step up its support for the NKPP bidding process and to begin preparations to provide a partial risk guarantee for the project.

¶5. (SBU) The letter also emphasized that upcoming PSC meetings should include discussions of how to link NKPP with the privatization of Kosovo B, as part of an integrated approach to secure a reliable and adequate supply of electricity for Kosovo while NKPP is being built. The USG offered to finance a feasibility study and bidding documents for Kosovo B's privatization. Along with the World Bank, the USG will also support a transaction advisor to guide the GOK through the process of offering Kosovo B to qualified private sector investors, including the prequalified NKPP bidders. Privatization of Kosovo B could also be supported by a World Bank partial risk guarantee, if requested by the GOK. Kosovo A was recommended for closure as soon as possible due to serious environmental concerns related to the plant's continued operation. The letter also urged appointment of a transaction advisor to move forward with the privatization of the Kosovo Electric Company's (KEK) distribution arm, to assure bidders that a creditworthy domestic buyer of power of will be available.

PM Accepts Way Ahead, Gets PSC/Cabinet Agreement

¶6. (SBU) CDA and World Bank Regional Representative Jane Armitage met with the Prime Minister on July 14 to discuss next steps. Although he had several questions related to the financing of these projects, Thaci supported the approach outlined in the letter, and said he would immediately take action to secure approval from the PSC and his cabinet to proceed with NKPP. The PM then held a press conference on July 15 to announce the government's decision; CDA, Armitage and representatives from the EC Liaison Office, IMF, and International Civilian Office stood by Thaci on the dais and gave remarks in a show of support during the conference. The PM explained that in cooperation with international donors, the GOK developed a five-point strategy to allow Kosovo to export energy while still meeting Kosovo's growing domestic needs. The steps include the construction of NKPP in two stages of 1000 megawatts each, along with a 40-year concession of the New Sibovc mine; pursuit of a public-private partnership for Kosovo B; the decommissioning of Kosovo A, with the support of the EC, by 2015; appointment of a transaction advisor for privatization of KEK distribution; and commitment to exploring renewable energy sources, in particular hydro power.

Next Steps

¶7. (SBU) The NKPP transaction advisor will next hold a series of consultations with PSC members and others to incorporate the guidance received from the GOK into a proposal for bidders. A draft Request for Proposals (RFP) document is anticipated to be released to bidders by September 2009. USAID is working with the World Bank and the EC to develop a detailed working timeline on four of the five points outlined in the PM's joint-energy approach: Kosovo A, Kosovo B, NKPP and KEK distribution. The USG, the World Bank and the EC have also discussed holding a donor meeting on energy

sometime in the fall to explore additional financing for the joint energy approach. The World Bank and the USG will prepare a draft paper on energy sector reform, in consultation with the European Commission (EC) that will serve as the basis for this meeting.

18. (SBU) COMMENT: The GOK's decision to move full-speed ahead with the NKPP project is extremely welcome news. Kosovo's citizens experience daily blackouts, and an increasingly larger share of the government's budget is being consumed by subsidies to the existing power plants and to cover expensive energy imports. Kosovo's future growth and development hinges on securing a reliable source of energy, and the GOK's decision to build NKPP is one step toward this goal. USEP will continue to work closely with the GOK and our international partners to ensure that this project and overall energy sector reforms remain a priority.

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